Ekaterina Panchenko

The possibilities of investing in Chinese Stock Market with a small budget.

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Abstract
Ekaterina Panchenko
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Saimaa University of Applied Sciences
Faculty of Business Administration
International Business
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Instructors: Timo Saarainen, Saimaa University of Applied Sciences

The purpose of this study to get familiar with the stock market in China as the option of individual investment for foreigners. The study analyses the market and the factors influencing it. The theoretical part is about the background of Stock Market and the current market operations. The emphasis is given on the market bubble of July 2015 and the governmental influence on the whole economical stability. Empirical part covers the issues of cooperating with brokers and trading with minimal budget with location in Beijing.

The information is gathered from the articles, business journals, investment books and online sources. The main source of information is business magazine: Bloomberg.com and Shanghai Stock Exchange Website.

The empirical part presents the outcomes of the interview with the broker firm representative.

Keywords: Stocks, foreign, trade
1 INTRODUCTION

The topic of this thesis is Chinese Stock Market and the ways in which foreign investors can participate. Investment overall is a great option to consider when starting a business, doing projects or willing to raise your funds. There are numerous of types to choose from if you have money and knowledge and everyone chooses the one or several according to their preference. Professional investors search for the opportunities of good revenue, safety and great prospects.

Being Global investor opens the great possibilities of earning as it reduces the limits of one-country option. Different projects, different companies and different markets give a huge freedom of choice and the investment opportunities one foreign country provides can bring much better results than investment options in your own country.

The choice for this thesis to be based on investment in China as one foreign country is obvious even at first glance. Looking at numbers according to the World Bank, as of 2012, China held 1.3 billion of the world's 7.1 billion people. Almost 20 percent of the world's population resides in China. Where the excitement kicks in is the makeup of this 20 percent China's urban population exceeded its rural population for the first time in the country's history, at 690 million people versus 656 million, respectively in 2011. From 1995 to 2016 the population of China’s middle class—defined here as households with annual incomes ranging from $6,000 to $25,000—grew from close to zero in 1995 to an estimated 87 million in 2005 and, according to MasterCard Worldwide, Asia Pacific, to 340 million by 2016. This fact shows huge consumer market rapidly growing in China and obvious factor for further economic growth and opportunities for foreign investors.

From the reforms taken in 1978, Chinese Gross Domestic Product (GDP) has been raising more than 10% annually and lifted 800 million people out from the poverty. The terrific development made it easier for people to start business, invest and get reach fast.

China's phenomenal economic growth has coincided with a substantial increase in Foreign Direct Investment (FDI) inflows and hence led researchers, including the author, to believe that increased inflows of FDI into China has had important
implications for the country's trade and economic development over the past decades, consequently giving wide opportunities for companies as well as individuals to successfully invest in Chinese economy.

In addition, according to Wall Street Journal (WSJ), starting from November 17, 2014 China opens the stock market for foreign investors, hence giving them possibilities for trading. This program allows investing in a wide range of companies that had been largely cut off from international money, and many of which are expected to benefit from the shift of China’s economy from manufacturing towards consumer spending. This reform seeks to bring globally accepted governance standards to the country’s capital markets and financial institutions. Rapid growth of the Stock Market resulted in huge profits for traders and investors making the market an attractive place for fast profits.

Besides the outstanding growth that has been seen in a few decades, Chinese economy also showed the periods of downs and sharp drops that are not typical for other economies. The economic instability caused by the Stock Market Bubble in June 2015 led to doubts of investors about the healthiness of the market.

1.1 Thesis Question

The underlying objective of this research is to find practical implications for investment opportunities in Chinese Stock Market in Beijing for individuals with limited budget and no investment portfolio and identify one most suitable option according to the assets available and find out the causes of economic instability. Furthermore, the paper aims to present what types, kinds and options of stock investments there are for foreigners on Chinese stock market. In order to make them more common, the author aims to get a guide, which consists of Stock Market Analysis, which includes the factors influencing the market, legal aspects, practical suggestions of experienced traders and examine the reasons for the economic instability of the market. That kind of secondary data can become a base for a research made by potential investors in order to understand a new market.
1.2 Limitations

This research takes into account only individual investor opportunities that are possible to implement in Beijing or through online mechanisms. The research will not consider the type of FDI that implies starting the business or applying the joint ventures and other business operating investment models. The source of money for investment in this case is personal savings or assets in real estate. The minimum budget is the basic requirement for this research.

1.3 Delimitations

This paper is based on the minimum budget of 30,000 RMB, which is roughly 4,000 EUR. This fact confines the research to focus on the minimal changes of the economy and examine the market from the point of view of the low-volatility investor. The common way to invest with the small budget for foreigners is funds. However, this paper is not considering the funds since the author perceives the personal practical understanding of the market and the primary location is Beijing. The Chinese funds appeared to be only available outside the mainland, which is contrary to our Limitations.

1.4 Research Method

Qualitative research methods will be implemented to find out what ways to investment into Chinese Stocks there are available for foreign investors, what kinds of limitations there are and what foreign investor can do to reduce the cultural and language barrier and get the maximum of his investment abroad. The main requirements are that they can be bought directly with small starting capital and that the fees are small in relation to the capital. The research is intended for a consumer that has little prior knowledge and experience in investing. The investment cases portrayed are supposed to reflect novice investing, so they are easy to implement and do not require a lot of managing. The price available on the market at the beginning of the period is used and it is expected that whole sum is invested at the going price. In the theoretical part the analysis of secondary data collected by statistical organizations will be
implemented. The empirical part requires a qualitative research with face to face meetings and open-ended questions or by phone call. The respondents are bank managers or brokers. The questionnaire will be planned and conducted in advance. The target for the interviews is to understand main points and the most important aspects, which were not published in online guidelines and on the bank’s websites that lead to the end question of the best option of Stock Exchange investment for a foreign individual with the minimum budget and knowledge.

1.5 Structure of the research

This paper is divided into three parts: theoretical, legislative and empirical. The first consists of a review and analysis of literature concerning this topic. Common definitions, facts and analysis will be presented and explained in order to ensure that the reader understands the whole picture about the Stock Market. The history of Chinese Stock Market as well as the current situation will be analyzed in order to find the best approach to the research question.

The second part is about legislation restrictions and norms, which are applied to foreign traders. That includes documents and approvals of money nature, ways and laws concerning their transaction to China, required actions for being able to operate as an individual on a stock market.

The last part covers the aspects that the theoretical part is lack of. Beijing has numbers of brokerage firms and investment institutions that provide broad view and particular information for every investor. This research is going to present them, analyze and give evaluation. Interview will be made for getting such data.

2 CHINESE STOCK EXCHANGES

For the foreign individual investor that wants to start with a small amount of budget it is worth to be aware of all types of investments available in this country. Chinese investment policy has recently had a lot of reforms and new regulations and the rules on foreign investment change fairly from time to time, making it important to follow for those who want to win in this giant Asian lottery.
Currently there are several types of investing those foreigners may consider as stable:

2.1 Types of investment allowed in china for foreigners

2.1.1 Enterprises

1. Sino-Foreign Equity Joint Ventures and Cooperative Joint Ventures

These are companies founded in China with joint investments from foreign businesses, enterprises or other economic bodies and Chinese economic bodies. Foreign company should have not less than 25% of ownership to be considered as a Joint Venture Enterprise.

The main difference from the equity joint venture is that investments of parties involved will not be changed into ratios of investments. The rights and obligations of participants with regards to such issues as distribution, investments, operations and sharing of risks and profits is determined by contracts signed by parties from the outset of the venture. These ventures take into consideration the foreign partner providing most or all of the funds while the Chinese partner to contribute land, facilities and most likely a limited amount of funding. The usual approach is stipulated in the contract that the Chinese party will own all assets of the venture until the expiration date, with the foreign party recouping its investments within the duration of the venture. Such forms of cooperative joint ventures are attractive, since they allow the Chinese partner to have a source of investment while permitting the foreign company to recoup its investments.

2. Wholly-Owned Foreign Enterprises

These refer to wholly foreign owned enterprises. They are companies set up in China by foreign companies or economic bodies in accordance with Chinese law with the investment entirely provided by foreign investors.

Such enterprises must be conducive to the development of the national economy; they must meet one of the following requirements:

- Application of internationally advanced technology
- Orientation of most products for exports
Corporate form of foreign companies in China is generally the limited liability company. The country has been late to provide a system for foreign enterprises, but they have grown in number over the past few years.

3. Chinese Holding Companies
Approval has recently been given to multinational corporations by China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) to establish foreign-invested holding enterprises. Though mostly analogous to Western Holding Companies, there are some differences. Multinational enterprises may wish to set up holding companies to increase investments or reinvestments in the country, as well as to coordinate investment companies already established here.

A Holding Company in the country may invest in such fields as industry, agriculture, infrastructure and energy, provided the State encourages foreign investments in these sectors.

4. Typical work undertaken by a Holding Company might include action as a purchasing agent, distribution or provision of after sales services. Provisional Regulations dictate that a Chinese Holding Company may enjoy preferential treatment of a foreign invested enterprise, and is awarded a foreign invested enterprise certificate and license.

5. Special approved foreign JV
Foreign nationals are generally not allowed to hold equity of private companies in the country unless with special consent from the government. A merger and acquisition exercise involving foreign funds will convert a private company into a foreign JV. (China Daily, 2013)

2.1.2 Individuals

1. B Shares
Chinese government entitles foreign investors to acquire shares of a special category, B shares, of approved listed companies in the Stock Exchange. However, ownership and management are separated. Chinese government is considering allowing a foreign invested entity in the country to be listed in the Stock Exchange, but it takes time.

(China Daily, 2013)
Due to the limitations of this research the focus on the investment into stock market for individuals is evident. The Stock Market investment generally has many advantages comparing to the other types of investment:

- *Doesn’t require a lot of funds.* Depending on the types of stocks and market due to the policies individual for every country, it still requires much less budget than any other type of investment.

As an example of joint venture investment, Eaten-Shen Pacific Corporation from San-Francisco made a joint venture agreement with Chinese CITIC bank designating an annual investment of $50 million to be made in the PRC through 1982. According to the Law, the foreign participant is expected to contribute twenty-five percent or more of the venture’s registered capital; (Salem, 2005)

The Chinese Holding Companies on the other hand may require the funding of US$1-5 billion for starting the small business, from the example in pharmaceutical industry. (PriceWaterhouseCoopers, 2009)

- *Easy to track and manage.* It became very convenient to monitor and manage your stocks with the online applications and computer software available nowadays in comparison to the phone calls you had to make in order to operate your investments.

- *Has more potential for growth.* The figure 1 exemplifies the result of a $100 investment made in 1926 in stocks, bonds, and short-term investments and what they worth today, made by Ibbotson Associates, 2015 (December 1925–February 2015).
2.2 Chinese Shares

<table>
<thead>
<tr>
<th>Type of Share</th>
<th>Market Place</th>
<th>Types of Investors</th>
<th>Limitations</th>
<th>Currency</th>
</tr>
</thead>
<tbody>
<tr>
<td>A- shares</td>
<td>China Mainland</td>
<td>Domestic Institutions and Individuals</td>
<td>Foreigners can trade if they become Chinese citizens</td>
<td>Chinese RMB</td>
</tr>
<tr>
<td>B- shares</td>
<td>China Mainland</td>
<td>Foreign institutions and individuals, Chinese holding a foreign bank account</td>
<td>Small number of companies listed</td>
<td>US dollars</td>
</tr>
<tr>
<td>H- shares</td>
<td>Hong Kong</td>
<td>Anyone</td>
<td>Requires Presence</td>
<td>Hong Kong dollars</td>
</tr>
<tr>
<td>S- shares</td>
<td>Singapore</td>
<td>Singaporeans and legible foreigners</td>
<td>Requires Presence</td>
<td>Singapore dollars</td>
</tr>
<tr>
<td>N- shares</td>
<td>New York,</td>
<td>Institutions and</td>
<td>US legislation</td>
<td>US dollars</td>
</tr>
<tr>
<td></td>
<td>NASDAQ</td>
<td>individuals entitled to trade in US.</td>
<td>L- shares</td>
<td>London</td>
</tr>
<tr>
<td>----------------</td>
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</tr>
<tr>
<td>J- shares</td>
<td>Japan</td>
<td>Unknown</td>
<td>Only a future opportunity</td>
<td>Japanese Yen</td>
</tr>
</tbody>
</table>

Table 1: Types of Chinese shares, made by the author

Here is the difference between Western economies’ definition of A- and B-shares and Chinese stock exchange. As evident from above listed Chinese stock types, the main difference of A- and B-shares class in China is that Chinese companies list the shares aimed for two types of investors – Chinese and Foreigner. Whereas, western companies such as Google, New York Times, Dow Jones, Washington Post and hundreds of others maintain A- and B-stocks according to the number of votes allowed per share. In the case of Google Inc., for example, class B shares are owned by the founders and top executives, and each share gets 10 votes, vs. one each for the class A shares sold to the public. (Investopedia, 2015)

The information about voting rights and dividends for A- and B-shares is planned to be included into empirical part, since Shanghai Stock Exchange website does not provide information on this question.

2.3 Qualified Foreign Institutional Investor (QFII)

Foreign investments in China are restricted due to foreign exchange control. The quota, products, accounts, and fund conversions are strictly monitored and regulated. Qualified Foreign Institutional Investor (QFII) Scheme is a transitional arrangement that allows institutional investors who meet certain qualification to invest in a limited scope of cross-border securities products, in the context of incomplete free flow of capital accounts. (Shanghai Stock Exchange, 2006)

China did not open the A-share market to foreign investors until 2002. This significantly limited foreign funds’ ability to tap China’s growth through the
domestic A-share market, which, as noted above, represents about 95 percent of total tradable Chinese shares. China’s introduction of the QFII scheme in 2002 offered an opportunity for foreign funds to participate in the A-share market. (Oscar Teunissen, 2007)

The approved list of companies allowed to trade the A-shares accounted 281 members in 2015. It comprised 26% of the total Share capital by June, 2015.

As it was mentioned before, foreign individuals cannot trade A-shares. However, it is possible to do so by contacting QFII representatives and asking for a possibility to trade A-shares through them.

Since this research takes place in Beijing, China, there is no possibility for including QFII into consideration. Additionally, Norway is the only Nordic country where QFII got approved. Swedish and Finnish institutions are in the process of applying to the membership and are planning to invest in China only be the end of 2017. Currently the major of approved quota countries include in: UK, USA, Japan, Hong Kong, Singapore, Taiwan, Korea, Norway, France and Netherlands.

2.4 History

First opened in 1842 in Shanghai it was known as International Settlement established by the treaty of Nanking that was promoting emergence of foreign markets in that area. Later in 1891 followed by the Chinese mining industry boom the first stock exchange was founded and the Shanghai Sharebrokers’ Association was established.

During the Second World War the stock market was closed as the number of foreign companies started to consolidate their economic control over the Chinese stock market and later the military of Japan took the control over Shanghai in 1941. Following Cultural Revolution and establishment of Social Market economy postponed the re-opening of the stock market for nearly 60 years.

The currently existing Stock Market re-opened in 1990 in Shanghai with secondary exchange founded in Shenzhen aiming mostly at technology and government securities. Hong Kong stock exchange was implemented into the Chinese system only in 1997, due to the fact that it has been under the British
Protectorate for a long time. Moreover, Hong Kong stock exchange operates under the special law that makes it more privatized than Shanghai and Shenzhen and gives more opportunities for foreign investment. This paper is making a research and emphasis on the Hong Kong Market separately despite it has its own legislation and longer experience. Since Hong Kong is now considered a part of Mainland China, the Stock Market here is also highly dependent, hence this paper is focusing on Mainland market as the major.

2.5 Mainland Market overview

From the official opening in December 1990 to 2002 the number of listed companies rose dramatically from eight to nearly fourteen hundred in Shanghai Stock Exchange and the number of investors in 2002 was just under 67,000,000. By September 2006 the two exchanges of Shanghai and Shenzhen listed 1,377 companies, with total market capitalization of US$400 billion with the number of investors exceeding 10 million in 4 years after the market opening. This severe growth was a result of the lack of policies and regulation governing the corporations and individual investors that were willing to enter the market. Amazingly, China had no laws to govern corporations until 1994 and no laws to regulate securities until 1999—nine years after the stock markets opened their doors.

The composite index on Figure 1 of Shanghai stock exchange shows the fluctuation and unsteady growth. Beginning in 1991, the Shanghai index went from 100 to 250 points in less than a year, and then reached 1,200 by the first quarter of 1992. By mid1992, multiples of 50 to 100 times actual earnings became the norm on the Shanghai Stock Exchange and some “hot” issues fetched even bigger cases. But by June 1992, the Shanghai stock market had dropped by more than 60 percent in a period of five months. Within a few days of hitting bottom, the bull market returned, and in just three months, the overall market index rose from 400 to a new height of 1,600. However, by the middle of 1994, the index was back to 400. From 1993 to 2001, the Shanghai market suffered twenty mini-crashes of more than 10 percent within a month. During the first decade of operation, overall market growth seemed spectacular—but it was an illusion.
From the end of 2000, the Shanghai Stock Market started facing a downturn that lasted for nearly 5 years right until the bubble in 2008. And the reason for it was due to Chinese government-backed investment companies that had raised billions of dollars to develop much-needed Chinese infrastructure: airports, toll roads, seaports, and especially power plants. But these trusts had been lending long and borrowing short— and in 1999, some went bankrupt or had to be bailed out by the Chinese government, further damaging the credibility of China’s business community. By 2001–2002, the fledgling securities industry also fell apart in scandal.

“I knew China’s investment mechanisms lagged behind the country’s breakneck development largely because the mechanisms were dominated by creaky state-run enterprises that didn’t have clear values, shareholder rights, or transparent accounting.” – said Him Rogers, investor and author of the “Bull in China” (Rogers, 2014)

 Tradable volume listed on China’s two exchanges declined by nearly 30 percent between 2001 and 2004. Figuring out how to reduce this overhang, one significant change was implemented by the government to stabilize the market:

While about 14 percent of shares worldwide were non-tradable, 70 percent of the value of China’s listed companies was in that category in 2002. Only 11 percent of listed companies were entirely outside government hands. Private investors losing a lot of money from the gradually declining market started protesting and the government began to sell the frozen stocks in order to recover the market and solve the private investors’ problems. By the middle of 2006, less than 50 percent of shares were state-owned, a dramatic improvement considering that in January 2002, the state owned 78 percent of equity shares. Through measured negotiations and provisions, significant progress has been made, and the government is clearly on track to meet its stated goal of floating all non-tradable shares. As the result after stocks started climbing in the summer of 2005, the Shanghai exchange went from around 1,000 index points to 4,000 by July 2007.

In consequence, this rapid boom of the purchased stocks caused the first economic stock market bubble in not long history of Chinese Stock Trade. The Shanghai Composite fell by 21 per cent from its peak at the end of November 2007, and the weekly trading volumes were down in line with share prices from 17 billion to 3.3 billion. (Financial Times, 2007)
The market stabilized by the end of 2009 and experienced the second huge crisis in July, 2015. This paper analyses the China Stock Market Bubble of 2015 in the separate chapter.

Despite the history, governmental influence, lack of experience in stock market investing and severe financial bubble crisis, China is considered a safe country in terms of investment and stock markets trade. It was ranked as “low risk country” in 2001 by the Political Risk Services Group (PRS), the leading organization in investment risk analysis. And in 2006, basing on several factors such as total foreign debt, international liquidity and exchange rate stability, China scored 47.5 on a scale of 50 followed by Japan with the score of 46. In fact, the United States has been considered as more unsafe country for investment since 2001 and before the tragedy in September 2011.

3 CHINESE STOCK MARKET BUBBLE 2015 AND GOVERNMENT INTERVENTION

In summer 2015, a dramatic fall in the prices of China’s stock markets suddenly wiped out USD trillions of the markets’ capitalisations: the Shanghai Stock Exchange Composite Index (SSE) fell from a record high of 5167 on June 12th to 3507 on July 8th (more than 32%, see Figure 2). The downward trend
continued and prices plunged below 3000 at the end of August, resulting in an overall loss of more than the size of France’s entire stock market. China’s domestic stock markets have climbed to near-historic heights from the end of 2014. Shanghai Stock Exchange, which is the biggest from two in mainland China, shot up 40% since the start of the year, while the other one, in the southern city of Shenzhen, has risen by more than 90%. Those outstanding figures could not continue to grow further and in June, 12th 2015 the market started to crash. In 12 months, Chinese stock markets rose enough to create $6.5trn of value. “That’s the equivalent of around 70%of China’s GDP in 2013, or about 40% of the total value of the New York Stock Exchange – or enough to pay off Greece’s debt 20 times over” – says Ana Swanson (Business Analyst) (independent.com.uk, 2015)

The history of Chinese Stock Market and its background show that it has been growing severely from the opening till now promising an attractive opportunity for a quick wealth. Dominating number of individual investors lacking of experience and knowledge comprise the 85% of the market making it highly volatile. China is a communist country that implies a strict control of the leaders over the people and mechanisms. Ordinary citizens are highly reliable on the officials and are easily influenced and managed. However, despite the obvious evidence of the upcoming market fall, the majority of investors kept maintaining a bull market.

Despite the shock to global markets over the size of this fall, the stock market collapse was not completely unexpected by market observers. What was unexpected, however, were the government’s reactions towards it. Not only did it effectively buy up stocks, it also suspended trading and initial public offerings and introduced even more controversial policy measures to boost stock prices, such as banning the sell-off of parts of companies and encouraging mergers. Figure 1 shows the Shanghai Stock Exchange (SSE) Composite Index.
To many observers, the actions of the Chinese government seemed panicked, not thought through and detrimental to the functioning of China's stock market according to market fundamentals. They resulted in a loss of confidence in the leadership's commitment to market reform as well as in their actual leadership capacities. Voices from within China reinforce this impression: In a lecture at the Peterson Institute of Economics, Yu Yongding explained the Chinese government's actions by saying: “To save the city, we bombed the city” (Yu, 2015)

The main actor in the 2015 stock market drama is the China Securities Regulatory Commission (CSRC), a ministry-level institution directly under the State Council that functions similarly to the US Securities and Exchange Commission. The 1998 Securities Law granted it the authority to regulate the securities and futures market of China and to ensure its legal operation. In addition to this, its main official goals do not only include the facilitation of the sound development of the capital market but also the “protection of investors, small investors in particular” (see main banner of the CSRC website: www.csrc.gov.cn, as of October 2015). Since the summer 2015 stock market crash jeopardized these goals, a whole range of governmental bodies was mobilized to intervene in early July, including the People’s Bank of China, the Ministry of Finance, China’s State-Owned Assets Supervision and
Administration Commission, the China Banking Regulatory Commission, China’s sovereign wealth funds, and others.

3.1 The Background: China’s stock markets and the World

In comparison to other stock markets, China’s two stock markets, the SSE and the SZSE, founded in 1990\(^1\), are very young exchanges. Even though they are not too far behind some of the world’s leading stock exchanges in terms of market capitalization and the number of companies listed, as shown in Table 1, their size compared to the overall economy is very small. In the US, the UK and also in Hong Kong, the market capitalization of stock markets accounts for more than 200% of M2 money supply, while the SSE and the SZSE currently reach the 30% mark only.

<table>
<thead>
<tr>
<th>Location</th>
<th>Market capitalization (trillion USD)</th>
<th>Number of listed companies</th>
<th>Market cap. in relation to country’s M2 supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>NYSE US</td>
<td>17.931</td>
<td>2 447</td>
<td>150%</td>
</tr>
<tr>
<td>NASDA Q</td>
<td>6.982</td>
<td>2 850</td>
<td>57%</td>
</tr>
<tr>
<td>LSE UK</td>
<td>5.796</td>
<td>1 267</td>
<td>243%</td>
</tr>
<tr>
<td>SSE China</td>
<td>3.952</td>
<td>1 071</td>
<td>18.5%</td>
</tr>
<tr>
<td>HKSE Honk Kong</td>
<td>2.992</td>
<td>1 816</td>
<td>202%</td>
</tr>
<tr>
<td>SZSE China</td>
<td>2.651</td>
<td>1 729</td>
<td>12.4%</td>
</tr>
</tbody>
</table>

Table 2: Comparison of China’s stock markets with large stock exchanges (figures as of September 2015)
These numbers reflect that whereas companies in the West are heavily dependent on equity financing, it accounts for only a very small part of corporate finance in China. Instead, bank lending, both in the formal and informal sector, plays a much larger role. In the US, bank credit accounted for 48% of GDP and stocks for 118% of GDP in 2012 in contrast to China, where these figures are exactly the other way around: Bank credit in China accounted for 128% and stocks only for 44% of GDP (Elliot and Yan, 2013). The consequence of this is that a sudden loss in the value of stocks has much less dramatic consequences for companies in China than it would have for companies in the US. The majority of Chinese companies finance themselves through bank credit and continued doing so throughout the stock market crash, whereas companies in the West or in Hong Kong would encounter much greater difficulties in accessing finance if stock markets contracted as they did in China this summer.

The Hong Kong Stock Exchange (HKSE) is treated separately from Chinese stocks not only because of the fundamental differences between the HKSE and Mainland China’s stock markets but also because it lies under the control of Hong Kong authorities, which in the terms of this paper is considered as one of the key factors influencing the market. However, as illustrated in the graph below, the HKSE stock exchange suffered similarly from the Chinese stock market crash. Nevertheless, this was not due to the fault of the HKSE or an inherent flaw in companies listed in the HKSE, but rather because of Chinese money flooding the market when the Shanghai-Hong Kong Connect opened in early April 2015, which allowed for direct investments between the SSE and the HKSE. During the launch period, the maximum trading quota was reached, boosting shares in Hong Kong, but when the mainland stock market suddenly crashed in June, Chinese investors were among the first to withdraw their money again from the HKSE. Following the Chinese stock market rally, a second, Shenzhen-Hong Kong Stock Connect, which had been planned to launch this year, is likely to be delayed.
Figure 3: HKSE from January to October 2015. Source: Yahoo Finance 2015.

Another major factor that differentiates China’s stock markets from the HKSE and stock markets in the West is the composition of its investors, which consists more of small rather than institutional investors (Elliot and Yan, 2013). In contrast to institutional investors, small investors suffer from an information asymmetry. Instead of evaluating the fundamentals underlying the value of the companies they invest in, they follow moves of the market and rumours and thus panic more easily. In fact, Bloomberg (2015) found that during the surge in openings of new brokerage accounts in the run-up to the stock market crash, two thirds were opened by investors who had not finished high school. Similarly, Yao and Luo highlighted already in 2009 that since China’s stock markets give millions of people, who had previously not been able to become rich, the opportunity to gain fortunes, China is particularly prone to stock market bubbles and crashes.

This investor composition is largely the result of policies of the Chinese government: First of all, China’s laws give shareholders considerably less influence over the management of companies than in other countries, which disincentives larger investors but does not prevent the aforementioned individual investors from buying stocks. In fact, since many publicly traded companies are majority state-owned, shareholder influence coming from parties other than the state is essentially blocked. As a result, movements in the stock market can also create panic much more easily than in other stock markets. The Chinese government played a crucial role in creating and bursting the 2015 stock market bubble on the one side, and in cushioning its impact on China’s
financial markets and the country’s society as a whole on the other side. In order to enable companies to exchange their high levels of debt for equity and in order to give savers an alternative instrument to invest their savings other than the declining housing market, the government actively promoted financial innovation and liberalization to accelerate growth in the country’s two stock markets. As part of this goal, it legalized and promoted margin financing, which grew at a stunning pace and thus created a very high level of leverage in a very short period of time. In addition to this, China’s stock market attracted a majority of small rather than institutional investors, which is why most decisions to sell or buy were not made on the basis of market fundamentals but rather in a speculative manner. As a consequence, stock valuations by far outpaced the country’s economic growth, which made stock market observers suspect the growth of a bubble and its soon burst months ahead of the price crash in June 2015.

The CSRC, however, also became suspicious of the markets’ rapid growth and the large number of highly leveraged positions, which often circumvented the minimum requirements it had set. While still trying to promote the development of the stock markets, for instance through the Shanghai-Hong Kong Connect, it already tried to derisk it but its actions led to rather than prevented the dramatic burst of the bubble. In the second half of June, after a tightening of margin requirements, prices fell rapidly and ultimately wiped out USD 2 Trillion of the country’s stock market capitalization. After the CSRC had unsuccessfully tried to dampen the share prices’ freefall throughout July, the government suddenly and unexpectedly introduced a myriad of interventions in the first week of July, which included a whole range of governmental bodies, such as the country’s Central Bank, the Ministry of Finance, China Banking Regulatory Commission and China’s sovereign wealth funds. An estimated RMB 1.5 Trillion worth of shares were bought up by government controlled entities in the following weeks, trading of certain companies’ shares and IPOs were suspended, credit requirements slashed and those who ‘manipulated’ the market or spread ‘rumours’ about its performance prosecuted. Nevertheless, prices kept falling after short periods of recovery and in mid-August, when they fell back to the pre-bubble levels of the beginning of the year, the government decided to no longer intervene in such a drastic fashion and to allow the market to make the necessary correction.
3.2 Crisis I

According to Yu (2015), the government’s actions to boost stock market prices had two clear aims: Firstly, he argues that it was a means to enable highly indebted companies, especially state-owned companies, to raise money in equity markets. According to Borst and Lardy (2015), state-owned enterprises account for 70% of the market capitalisation of listed A-share firms, even though the private sector accounts for 65-75% of economic output. In fact, economists would argue that this is why China’s stock markets were flawed from the moment of their very creation: Mao Yushi, for instance, said that “when China’s stock market was set up, its aim was to help state-owned enterprises raise money. It went wrong at the very beginning” (Mao Yushi, quoted in the New York Times 2015a).

Secondly, Yu (2015) argues that the government hoped to stimulate demand via the wealth effect. However, economic studies found only ‘weak’ evidence that increases in stock market wealth typically lead to increases in consumer spending (Case, Quigley and Shiller, 2006). It is nevertheless likely that the government sought to offer the people the stock market as a new way to store their wealth and thus maintain their impression of being wealthy, even if it would not directly lead to increases in demand. Considering that 66.1% of family assets in China were in housing in 2013 (Bloomberg, 2014) and that the prices of houses have fallen considerably over the course of the past year (see the change in prices for new built houses in Figure 2), a shift of wealth from housing to stocks could at least have dampened the negative wealth effect that falling house prices were already having on consumer spending.

Figure 4: Year on year changes in newly built house prices: With 2014, the growth in prices started to fall and finally crossed the zero-growth line to
become negative, which it still is today. Source: National Bureau of Statistics of the PRC

However, the problem in this argument is that in fact, China’s stock market boom prior to June 2015 was fuelled by the country’s growing debt. The result of the government’s action was therefore not to put the people’s existing wealth from the collapsing house market to safer investments that would guarantee their wealth, but to give them another opportunity to become wealthy without actually creating wealth.

One of the key factors in this process and also one of the key drivers of the stock market boom was the government’s decision to legalise margin financing in 2010: Just like taking out a mortgage to buy property, the January 2010 “Guiding Opinions on Pilot Margin Trading and Short Selling Business among Securities Companies” permitted investors to borrow money from brokers to buy stocks. In margin financing, the stocks bought serve as collaterals, and the minimum margin requirement (usually 50%) determines how much of his own cash the investor has to commit. As such, margin financing magnifies the losses and the gains made on securities: When share prices fall, the net value, i.e. the difference between the security and the loan, increases, forcing the investor to commit more of his own money or to sell the stocks for a loss. When share prices rise, the investor benefits not only from the gain in stock value bought by his own money but also those bought by the loan.

After being launched as part of a pilot programme, rules on margin financing became a national standard in 2011 and in 2013, requirements on the investors’ accounts were lowered and the initial minimum value of their holdings cancelled. Regarding regulatory aspects, margin financing in China is not much different from other countries, such as the US, and also the level of margin loans in the Chinese stock markets was not perceived as particularly worrying (Financial Times, January 2015). However, two issues raised major concerns among investors and increasingly also within the Chinese government about leverage in the stock markets: Firstly, the speed in growth of margin financing was unprecedented. Figure 4 shows that the outstanding balance of margin transactions rose potentially from RMB 12.7 Billion in 2010 to a record of over RMB 2 Trillion in June 2015.
Secondly, investors and regulators became increasingly concerned about leverage because margin financing was the more transparent part of the debt invested in stocks and similar growth pattern was suspected to be found through other, less transparent debt instruments. Analysts from Credit Suisse estimated in May 2015, that “total outstanding borrowing related to stock market is probably 2x or more than the margin financing data suggests” (Credit Suisse, 2015: 7). This estimate accounts for significant amounts of non-bank loan instruments, such as umbrella trusts and stock return swaps, and also ‘misused’ household and SME bank loans that could have flown into the stock market. Moreover, news reports highlight several creative ways that investors invented to circumvent official rules on margin financing, such as online lending websites (Bloomberg, 2015a) or risky wealth management products (Bloomberg, 2014a).

In addition to the introduction and facilitation of margin financing, it could be argued that the government further fuelled the credit boom and as such the growth of the stock market bubble by loosening monetary policy, including several cuts in the interest rate (Figure 5) as well as in the required reserve ratio (RRR) which determines how much money banks can lend (Figure 6). However, it is important to see these decisions in light of the larger, macroeconomic trend that China’s economy had started to slow down: Rather than increasing the money supply in the market and thus encouraging lending, these actions were necessary in order to offset reversing capital flows and meet money supply targets (The Economist, 2015). Furthermore, despite the fact that the government’s multiple cuts in the RRR (starting in 2012 and again from February 2015 onwards) mark a turning point in its efforts to withdraw domestic
liquidity surpluses, China’s RRRs (currently at 18% for big banks) remain at a very high level compared to other countries.

Figure 6: China's Interest Rate in percent; Source: People's Bank of China, 2015.

Figure 7: China's Required Reserve Ratio for big banks in percent; Source: People's Bank of China, 2015.

It is very likely that, as analysts from Credit Suisse (2015) suggested, the government itself did not know precise figures on the actual growth of credit and leverage in the stock market and it clearly did not expect the dramatic fall in stock prices in June. Nevertheless, it did become suspicious of the rapid growth in the country’s stock prices and their sustainability already at least six months prior to the crash, when it started to take actions to stabilise the stock market boom and actively lower the prices as detailed in the next section. In fact, Frankel (2015) argues that it was precisely the government's intervention, namely the June 12 announcement that the CSRC would increase requirements for margin lending, that ultimately ‘pricked’ the bubble. In order to comply with
the new standards, financial institutions suddenly withdrew their investments, resulting in a freefall in stock market prices. Prof Ding Yifan from Peking University compares the government’s behaviour to that of an inexperienced driver: “At the beginning, it steps up on the gas, and when the vehicle runs too fast, it fears, and slam[s] the brakes” (Ding, 2015).

3.3 The run-up to the crisis II

Considering that the economy was already slowing down and profits declining, the upsurge in stock prices from November 2014 onwards clearly did not reflect the performance of the underlying companies (see Figure). When the government became aware of the fact that this growth was unsustainable and it had, on the contrary, created large risks for economic stability, it tried to stabilise and derisk the stock market by reducing leverage.

![Figure 8: The contrast between China's GDP growth and the performance of its stocks, taking Shanghai's CSI 300 Index as of May 2015. Source: The Economist 2015.](image)

In January 2014, the CSRC made its first move to clamp down on margin financing by suspending three major brokers (Citic Securities, Haitong Securities and Guotai Junan Securities Co.) from opening new margin-trading accounts for a period of three months because they had violated rules on margin trading. The sudden tightening of the regulator’s grip over brokerages caught investors by surprise and resulted in the worst fall in the SSE in more than six years (see Figure 2).
In April 2015, China’s two stock exchanges issued rules that facilitated short-selling (i.e. selling of stocks that the investors does not own but hopes to buy at a later point when stock prices have fallen). This facilitates betting against the price movements and spurred the CSRC’s fears over the stability of the stock markets. Moreover, at the same time, the Shanghai-Hong Kong Connect was opened, which enabled investors from both stock exchanges to directly invest in each other’s stocks and which again boosted turnover rates.

The CSRC thus introduced limitations for margin trading of high-risk trades of over-the-counter stocks and started to ban umbrella trusts, which is a type of financing through which investors borrow money for stock purchases not directly from brokers but through alternative channels, such as trust companies. This allows them to circumvent regulations on minimum margin requirements and to increase their leverage. Moreover, the CSRC repeatedly issued warnings against brokers to control the risks arising from margin financing and requested more information on their clients’ stock market exposure, which prompted them to tighten rules on margin requirements (Financial Times, 2015a).

In addition to this, the government’s official rhetoric changed: Instead of praising ‘cheap’ stocks in the state media, the CSRC and official state media now issued warnings to investors, especially small ones, advising them to invest “rationally” and to refrain from taking out loans or selling property in order to buy stocks (People’s Daily, 2015; Xinhua, 2015; Xinhua, 2015a).

Nevertheless, stock market became increasingly unstable in the run-up to the crisis: Record daily losses were made in the beginning and in the end of May, which could have maybe been even worse had it not been for the government’s regulation that limits the fall in value of individual stocks to 10% per day. Stock markets analysts in foreign media increasingly warned against the bubble-like growth of the Chinese stock market: The Economist (2015), for instance, highlighted the ‘irrational exuberance’ in China’s stock market ‘casino’ in late-May and compared the valuations of China’s start-ups to the Nasdaq in 1999, shortly before the US’ dotcom bubble burst. The fall of share price in the following month, when the government suddenly increased margin requirements, was therefore a necessary and much expected correction, rather than as China’s state officials tried to convince the public “an irrational sell-off” (quote of a spokesperson of the CSRC in CNN 2015). However, because of the structure of the stock market, in particular because of the fact that it was largely
financed by debt, the correction turned into a spectacular collapse of the market. When prices started falling, the market did not recover quickly enough to prevent margin calls that forced investors to sell their assets, leading to even steeper falls in stock values and finally forcing the government to step in.

Figure 9: The Run-Up to the June 2015 Stock Market Crash: Interventions of China's government in the stock market compared to the Shanghai Stock Exchange Composite Index
Source: Yahoo Finance 2015 and compilations of the author.

3.4 Governmental Influence on Stock Market

According to the study conducted in the University of St. Gallen the Chinese government has stronger influence on stock market, comparing to other economies. The study analyzes the impact basing on the overview of two factors – Monetary Policy and Fiscal Policy. Here is a short overview of the study given below:

Monetary Policy:
- Interest Rate – which is the price the borrower pays for using an asset at the given amount of time. The higher the interest rate – the more worthy
is the asset. When interest rate increases, the borrowing cost rises. Investors will thus cut down the allocation to the stock market as it is considered to be more risky. Also, a higher interest rate causes higher return on cash deposits. Additionally, it affects the operation of companies, changing their profitability, investors' expectation and stocks' inherent value.

- Money Supply – the research states that the year-on-year M1 growth has a significant visual correlation with the Shanghai Composite Index. Facing the danger of an overheated stock market and inflation driven by the booming economy, the People's Bank of China tightened the money supply by increasing required RMB reserve ratios 10 times in 2007, from 9.5% to 14.5%, aiming to limit the currency in circulation so as to support a reasonable credit growth. In fact, the strong policy change did indeed slow down the growth of M1 and M2 but it didn’t overturn the situation of excess liquidity. This was owing to a high trade surplus and a large amount of individual bank deposits. A report from General Administration of Customs shows that the trade surplus in May 2007 expanded to more than USD 23 billion, 73% higher than the year earlier.

Fiscal Policy:

- Government Spending

Compared with monetary policies, government spending change creates more immediate impact on domestic economic growth and consequently benefits the stock market. The Figure 4 illustrates the example:
Government Bonds – the study states that a government bond is regarded as a risk-free bond as the government can always repay by raising taxes or printing more money to redeem the bond at maturity. State bond issuance can change the money supply and circulation. Although there is no guarantee that this increase in relative risk will be accompanied by a change toward risk aversion, nevertheless, a shift toward relatively safe, fixed income securities plus money may be expected. With the state purchasing the Governmental Bonds, regular investors are forced to change the portfolio in order to avoid risks.

Taxation – taxation regulations in general lead to Stock prices change. Chinese government has a number of changes in VAT system in recent years. Not influencing directly on Stock market, it definitely has an effect on Trade through implementing different taxation reforms. Adding to the domestic consumption stimulation measures besides VAT deduction, from November 1, 2008, the government has reduced the property deed-tax for first-time buyers from 1.5% to 1%, temporarily waived land VAT and stamp duty on transactions of real estate. This reform had direct influence on Stock Market as it improved
consumer buying power and caused the market to climb significantly in 2008-2009 along with the Real Estate Index. (Wang, 2010)

As it was stated before, the Chinese government played a crucial role in creating and bursting the 2015 stock market bubble on the one side, and in cushioning its impact on China’s financial markets and the country’s society as a whole on the other side. In order to enable companies to exchange their high levels of debt for equity and in order to give savers an alternative instrument to invest their savings other than the declining housing market, the government actively promoted financial innovation and liberalization to accelerate growth in the country’s two stock markets. As part of this goal, it legalized and promoted margin financing, which grew at a stunning pace and thus created a very high level of leverage in a very short period of time. In addition to this, China’s stock market attracted a majority of small rather than institutional investors, which is why most decisions to sell or buy were not made on the basis of market fundamentals but rather in a speculative manner. As a consequence, stock valuations by far outpaced the country’s economic growth, which made stock market observers suspect the growth of a bubble and its soon burst months ahead of the price crash in June 2015.

The example of the Bubble 2015 shows the importance for investors, both local and foreign, to be aware of the financial changes that government applies. Doing investment in Chinese Stock market seems to be as sitting on a powder keg. The Chinese government played a crucial role in creating and bursting the 2015 stock market bubble on the one side, and in cushioning its impact on China’s financial markets and the country’s society as a whole on the other side. In order to enable companies to exchange their high levels of debt for equity and in order to give savers an alternative instrument to invest their savings other than the declining housing market, the government actively promoted financial innovation and liberalisation to accelerate growth in the country’s two stock markets. As part of this goal, it legalized and promoted margin financing, which grew at a stunning pace and thus created a very high level of leverage in a very short period of time. In addition to this, China’s stock market attracted a majority of small rather than institutional investors, which is why most decisions
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The CSRC, however, also became suspicious of the markets’ rapid growth and the large number of highly leveraged positions, which often circumvented the minimum requirements it had set. While still trying to promote the development of the stock markets, for instance through the Shanghai-Hong Kong Connect, it already tried to derisk it but its actions led to rather than prevented the dramatic burst of the bubble. In the second half of June, after a tightening of margin requirements, prices fell rapidly and ultimately wiped out USD 2 Trillion of the country’s stock market capitalization. After the CSRC had unsuccessfully tried to dampen the share prices’ freefall throughout July, the government suddenly and unexpectedly introduced a myriad of interventions in the first week of July, which included a whole range of governmental bodies, such as the country’s Central Bank, the Ministry of Finance, China Banking Regulatory Commission and China’s sovereign wealth funds. An estimated RMB 1.5 Trillion worth of shares were bought up by government controlled entities in the following weeks, trading of certain companies’ shares and IPOs were suspended, credit requirements slashed and those who ‘manipulated’ the market or spread ‘rumours’ about its performance prosecuted. Nevertheless, prices kept falling after short periods of recovery and in mid-August, when they fell back to the pre-bubble levels of the beginning of the year, the government decided to no longer intervene in such a drastic fashion and to allow the market to make the necessary correction. (The personal conclusions of the author based on various sources from Bloomberg.com, wsj.com etc)

4 CHINESE PRACTICES FOR STOCK MARKET TRADING

According to the Shanghai Stock Exchange legal policy for foreigners, the last are entitled to choose from two Order methods when entering a B-share market
Generally, order methods include:

- **Desk to desk trading booth orders**
  Desk to desk trading booth orders: investors themselves or their designated agents personally go to the B Shares trading booths of securities departments to complete orders. The minimum of 100 stocks by purchase or 1000 yuan has to be traded in one order. (Shanghai Stock Exchange, 2006)

- **Self-service orders**
  These can be divided into phone orders, online orders and self-service terminal orders. Investors themselves or their designated agents offer instructions for the trading of securities to a broker via telephone, fax, telex and other means of communication. They are generally completed by called phone order. Offering instructions for the trading of securities through an online shares order system is generally called an online order. Offering instructions for the trading of securities through self-service terminal system of a broker is called a self-service terminal order. Phone orders are a common way of placing orders for B Shares. Therefore, keeping telephone records (or fax papers) is extremely important. It is generally required to keep these records for relatively long period. The minimum of 100 stocks by purchase or 1000 yuan has to be traded in one order.

Hong Kong and Overseas Investors who trade through Shanghai Stock Connect trade shall follow the same shareholding restrictions as QFII and RQFII.

- One single foreign investor’s shareholding in a single listed company shall not exceed 10% of the total number of shares of the listed company;

- All foreign investors’ shareholding in a single listed company combined shall not exceed 30% of the total number of shares of the listed
companies.

• Provisional Monitoring Measures for Shanghai Stock Connect trade are as follows:

• When total shareholding proportion of all foreign investors to a single listed company ≥ 26%, SSE will publish notice on its website

• When total shareholding proportion of all foreign investors to a single listed company ≥ 28%, HKEx will restrict buy orders for the particular company’s stock

• If total shareholding proportion of all foreign investors in a single listed company reaches or exceeds 30% due to Shanghai Stock Connect trading, they will be required to sell shares within 5 trading days according to the “sell first then buy” principle;

• If total shareholding proportion of all foreign investors in a single listed company drops to or below 26%, HKEx will restart accepting buy orders on the following trading day. (Shanghai Stock Exchange, 2015)

Foreign traders are entitled to receive dividends. From the year 2011, the new exchange guidelines encourage listed companies to return 30% of the profit to the shareholders in order to earn confidence in China’s equity markets. Those companies “who regularly make dividend payments and “satisfy” investors will be placed in a “green light channel” for any financing and mergers and acquisition activity that relates to the exchange’s supervision”. (Rabinovitch, 2013) The official website of Shanghai Stock exchange does not provide any information on the dividends given by the listed companies. However, according to Top Yields, dividend tracking web engine, there is a huge number of companies trading B-shares that provide dividends. The list of the companies issuing dividends is enclosed in Appendix 1.
Despite the changes made in advantage of the investors, those remain looking for a price increase as the main source of profit.

4.1 Bank Lending

Limited trading resources bring us to a consideration of bank lending options. As it was mentioned before in this paper bank loans for stock market trading is a common practice since bank credit in China accounted for 128% of GDP, while in the US it is only 48%. The 60% of shares traded in 2015 were purchases with bank loans. (Bloomberg News, 2015) By the summer 2015, Chinese brokers have raised 2.1 trillion RMB ($339 billion) of margin finance to investors, which was twice bigger than at the start of the year. This figure shows direct financing and does not consider other sources of financing that were flowing into the stock market investment. According to Wall Street Journal, Chinese government started encouraging investors to borrow more money for buying stocks in 2016. The interest rates got decreased and the lenders apply better conditions to attract borrowers. (Hong, 2016)

Foreign residents, except those holding tourist visas, are entitled to take a loan in a bank for personal investment. Every bank in China has different conditions for Investment loans. Here are the requirements for Personal Investment and Business Loan of the Bank of China:

The loan should be not less than 30,000RMB, not more than 3,000,000RMB and taken for not longer than 5 years. The borrower is required to show the income statement, ID, employment certificates, certification of personal funds of at least 30% from the required loan. There are some other supportive documents required that are helpful for loan approvement. Borrower should personally contact the bank to consult on the additional documents. Before signing the loan contract, you are required to provide Bank of China with property mortgage, pledge or irrevocable joint liability guarantee from the third party, which is identified by Bank of China; and the guarantor must sign the contract of guarantee in written form. (Bank of China, 2016)
Interest rates vary depending on the loan period. The banks are lowering the rates, hence 182-days loan has only 3% of the interest rate, while 90-days loan – 3.2%. (Bloomberg News, 2015)

There is a lot of criticism towards the government and financial institutions attracting the borrowers since the years 2015 and 2016 show the highest numbers in Bad Loans. The non-performing loans jumped by 51% in 2015 with 1.27 trillion yuan. Despite the huge risk, financial institutions raised the loan number by 15.6% in January 2016 extending it till 2.51 trillion yuan.

The experts affirm that these actions put the entire Chinese banking system at risk since it is impossible to grow it at 1000% without downturn. (Scutt, 2016)

5 EMPIRICAL PART

Any stock trading process goes through the brokerage firm face to face by contacting them personally, by phone or online. The stocks can also be traded directly through the listed enterprises or online applications. In order to get maximum information on the trading process, conditions and suggestions, the practical part is decided to be based on the interview with the Brokerage firm representative. The brokerage firms were selected according to the results of the list given buy Google, as it is assumed that the results would show the international or English speaking service providers. The listed firms have their websites designed both in English and Chinese and claim to provide international assistance. The phone-calls were made in order to select a couple of interviewees from different firms. As it appeared to be fairly difficult to find English speaking assistance in Beijing, the interview is made with one person – the business lawyer working on trading violation cases independently and in cooperation with China CITIC Securities. The qualitative approach is implemented in this part including an interview. The interview is comprised with a number of open questions that are designed in order to find out the lack of information on A- and B-Shares traded in Shanghai and available from Beijing or any other sources. The face-to-face interaction is required due to the aspects of investing that have to be discussed personally.
Several Brokerage firms were contacted beforehand. The list of companies could be found in the official Shanghai Stock Exchange page. The author picked the companies with the contact information and location in Beijing area and from the pages in English to find out if they have English-speaking representative available or if they deal with B-shares among with A-shares.

The companies chosen for the first call:
- China CITIC Securities Co., Ltd.
- Beijing Securities Co., Ltd.
- Great Wall Securities Co., Ltd.
- Sun Securities Co., Ltd.
- Bohai Securities Co., Ltd.
- GF Securities Company
- China Communication Securities Co. Ltd.
- Changjiang Securities Co., Ltd.
- Everbright Securities Ltd
- United Securities Co., Ltd.

After the phone calls there were only two companies left that could offer the service in English: China CITIC Securities and China Communication Securities. The appointment for the face-to-face interview was made with the representative from China CITIC securities. CITIC Securities is one of the leading full-service investment bank in China that provides all kinds of services connected to investment. It has been awarded as a “Best Broker in China” by Finance Asia and has been operating in China since 1995. http://www.citics.com.hk/

The interview questions were designed basing on a certain Investor’s background: The holder of temporary Business visa, individual investor with the average budget of 30,000 CNY, which equals to nearly 3,000 EUR. The investor is willing to make long-term investment into Chinese stocks with the possibility to sell and quit any time needed. The only option is to trade from Beijing or online. The following questions are aimed to fill the gabs in theoretical part and are analyzed and designed by the author according to her own
knowledge and also theoretical outcomes. These questions are considered to be enough to fulfill the information gaps and start investing.

The list of interview questions follows:

1. Can foreign individuals buy B-shares and A-shares?
   The new regulations for foreign traders allow them to almost freely invest into Chinese companies. However, the regulations are not clear about the types of foreign investors. Shanghai Stock Exchange provides a lot of information on corporate investment and international relationships through bonds, although not mentioning much about options and benefits for foreign privates. Additionally, despite the rule that A-shares are made for Chinese citizens, the regulations mention residence permission that allows foreign holders participate in trading A-shares among with Chinese locals.

2. Can I invest outside of China? If yes, what are the available ways to trade?
   There are numerous of mobile applications for trading on both Shanghai and Shenzhen Exchanges. However, they are all designed only for Chinese speaking users.

3. Do I need to have a residency permit and bank account in Chinese bank to trade or is it possible to trade through international banks?

4. What would be a recommended amount of money to enter the B-shares market?
   Besides the minimum requirements for entering the market, there is also a certain amount that would satisfy your plan for returns. Obviously, more money invested means more money returned. We yet have the minimum budget to operate.

5. What market would be recommended to enter for short-term investment rather than long-term and vise versa?
   A-share and B-share markets are significantly different and they should be treated separately.

6. Can I trade the B-shares without brokerage firm (through the trading apps)?
   To the question about English mobile applications or computer software.
7. Are there brokerage firms located in Beijing that I can trade through that would be able to consult me on the particular shares and provide the analysis on stock market in English.

8. How can I secure myself working with the brokerage firm? Is there any institution I can refer to when claiming my rights?

Securing your funds as well as your rights as a foreign individual in another country is a wise thing to consider in any case. Planning and organizing your security is one of the first things to do when investing abroad.

9. What are the requirements for a foreign individual investor that wants to enter the A-shares market (legal documents, recommended amount of money)?

10. Do any B-shares provide dividends?

Since the research is aimed to find out the most profitable ways of investment in Chinese Stocks, long-term investment is one option that needs to be clear.

11. Would you recommend entering the market now after the crash in July or is it safer to wait to market to fully recover?

There are many concerns about the future of the Chinese exchanges after the Bubble of July, 2015. Specialists have different view on the safest time to enter the market. The opinion of the professional brokers that have big experience in this field would be highly important.

12. Chinese economy develops very fast, yet there is still strong governmental control over the financial system in China. Do you think if changes towards a control loosening are going to happen in the near future?

This question can help us to know if the situation on the stock market and financial sector of Chinese economy is going to have some positive reforms. The long-term investment requires studying of every aspect of the economy in order to eliminate the risks.

6 RESULTS

Originally the firms informed that they provide English speaking assistance but it appeared that the only one English-speaking broker was available for an interview. He mentioned that English assistance is more likely to be found in Shanghai where the Stock Market is located.
Changhui Li, business lawyer China CITIC Securities and his answers are listed below:

1. Can foreign individuals buy B-shares and A-shares?

Generally, only B-shares accounts can be opened for foreign individuals.

However, there is an exception for this general rule. If a foreign individual obtains the permanent residency qualification of China, the foreign individuals can also open A-shares as well, because they are deemed as a Chinese Resident.

Please note that the foreign individuals don’t include the residents of Hong Kong, Maocao and Taiwan, all of those are deemed as Chinese Residents in this regard now and are allowed to open the A-share accounts now.

2. Can I invest outside of China? If yes, what are the available ways to trade?

You can certainly invest through the QFII (Qualified Renminbi Foreign Institutional Investors), which can in turn invest directly in the A share market. The QFII are not entities with a registered address in China and are registered in foreign countries (like Japanese, U.S. or France).

The government maintained an updated list of above-mentioned qualified investors. You may probably find the qualified investors list on the official website of CSRC (China Securities Regulatory Commission). Generally speaking, only the top-level giant financial groups in their foreign countries can be recognized as this kind of qualified investors.

So you can contact this qualified investors, and invest in China A-share through them.

3. Do I need to have a residency permit and bank account in Chinese bank to trade or is it possible to trade through international banks?
You need to submit some documents to open your B-share accounts.

There are some materials to be required as follows:

If you are a foreigner with permanent residency qualification, when you open the A-share account or B-share account, you should submit the completed application table, investors identification evidence materials (permanent residency evidence).

If you are a foreigner without permanent residency qualification, when you open the B-share account, you should submit the completed application table, some copies of investor’s identification evidence materials (passport).

4. What would be a recommended amount of money to enter the B-shares market?

To my knowledge, there is no minimum cash requirement, it depends on you, for me, I would consider at least 50,000RMB or more especially if you want to invest in short-term. However, you can just ask for advice from the staff of brokerage firm when you open the account.

5. What market would be recommended to enter for short-term investment rather than long-term and vise versa?

If you hold only a limited amount of money it is surely safer to invest in long-term. It depends on your own strategy. No specific and fixed way.

However, I heard some skills from professional individual investors, long-term investment seems to be safer for ordinary people, and should not always follow others on the trend of stock price. It is believed that some people can be able to manipulate the stock price of small listed companies, so some people say it is wise decision to do some research about the value of specific stock, and then make a long-term investment.
6. Can I trade the B-shares without brokerage firm (through the trading apps)?

To my knowledge, you should open the account first with the brokerage firm before you make the investment, and then you can make decision and phone the staff to help you operate the decision.

7. Are there brokerage firms located in Beijing that I can trade through that would be able to consult me on the particular shares and provide the analysis on stock market in English.

Yes. You can try to contact the (中信证券股份有限公司). You may find the contact telephone number online.

8. Do any B-shares provide dividends?

Actually, B-share listed companies are not familiar to me. But A-share listed companies should follow the CSRC requirements of compulsory dividends percentage (generally annual dividend should not less than 10% of the annual distributable profit of the listed company).

You can consult the brokerage firms to clarify your concern.

9. How can I secure myself working with the brokerage firm? Is there any institution I can refer to when claiming my rights?

In China, I believe it is not wise to sue a china brokerage firm for an individual foreigner. But there is a judicial remedy available for you. You can sue to the competent court against any default of the broker about the agreement between you.

10. What are the requirements for a foreign individual investor that wants to enter the A-shares market (legal documents, recommended amount of money)?
As mentioned above, you can invest in the A-shares market through the QFII and QRFII. It is then an issue of this type of qualified investors, and they should give you specific instruction about your investment in them.

11. Would you recommend entering the market now after the crash in July or is it safer to wait to market to fully recover?

Everyone has a different judgment about the market situation and potential trend. It is hard to evaluate the potential and predict the future especially on stock markets. So it is up to you to taste an opportunity to invest now or to be prudent to wait for a better chance in the future. For me, I would rather wait for the market to fully recover.

13. Chinese economy develops very fast, yet there is still strong governmental control over the financial system in China. Do you think if changes towards a control loosening are going to happen in the near future?

The interviewee softly refused to answer this question saying that he is not sure about it.

6.1 Interview Interpretation by the Author

Practical aspects of investing in China do not seem to be very complicated. Interviewee suggested QFII as an alternative option for foreigners to invest in Chinese stocks, particularly in A-shares. This research is focused on direct investment in Chinese Stock Market and QFII investment can be aimed for another research. The other option for an investor to trade A-shares, according to interviewee, is holding a permanent residence permit. Permanent residency, according to governmental rules, can be given to a foreign individual as follows:

- Marriage
- Family Reunion
- Investment (The minimum of USD$500,000)
- Employment (Permanent Residency for employment is considered individually and mostly is given to high quality specialists with outstanding and unique skills and knowledge) (Travel China Guide, 2016)

The recommendation for long-term investment is reasonable considering the economical instability that China is facing nowadays. Short-term investment seems to be too risky with amount of funding available.

In question 7 the interviewee mentions 中信证券股份有限公司 as a reliable brokerage firm located in Beijing that can consult me on particular socks. As it appeared to be this was simply the Chinese name for CITIC securities where the only English-speaking person that agreed to provide assistance was our interviewee. Hence, this question did not bring any results.

The list of the companies providing dividends was found later online and compared with the rates mentioned on Shanghai Stock Exchange website. The list of companies giving out dividends is listed in Appendix 1.

The interviewee suggested that with the current economical situation, governmental influences and financial limitations, the investment in B-shares is prosperous in a long run. The government is regularly applying reforms that make it easier for foreign investors to trade on Chinese Stock Market. However, current political behaviour brings us to the conclusion that the year of 2016 is not the safe time to enter the market, since the boom of Chinese economy now turned to a sharp decline, not without the Governmental influence.

7 CONCLUSION

7.1 Research Outcome

The aim of the research was to provide information for individual investors willing to start their investment portfolio in China. The aim of the thesis was to give clear understanding of the Chinese economy mechanisms, factor influencing the market and potential and existing risks that have to be considered for successful investment. Individual investors can utilize the
Empirical data was collected through the interview and aimed on giving a broader picture on the stock market operations and trading opportunities for foreign individuals. Due to the language barrier and professional unreliability of Chinese brokerage firms, only one interviewer was found. The cultural aspect played a huge role in the interview and stood for the reason of the information gaps of the empirical part. The way of communicating typical for Chinese culture requires a close personal connection that has to be built before the business. The trustworthy relationships with the interviewee were not possible to arrange due to the limitations of the author, that were – the limited time, money, knowledge, language barrier and the background of the author. The information received on the interview showed that with the current reforms, political and economical instability the budget planned for the investment couldn’t be a safe amount for stock trading. However, the interviewee is sure that the market is going to be the safer place in a long run.

Practical part was comprised with the overview of the possible investment options for foreign individuals and then focused on the stock market as the best of them. Chapter 3 provided an analysis of the reasons for stock market bubble in June 2015 and gave the conclusions about the political and legal environment influencing the market. The conditions limiting the investment opportunities showed a small amount of options for investment. The practical result can be considered as not fulfilled, due to the cultural aspects, language barrier and location. Brokerage firms located in Beijing seem not willing to deal with individual foreign investors, due to the language barrier or a potential unattractive budget. The budget of 30,000 yuan can be practically and legally enough for trading stocks in China. However, due to the economical instability and the market crash in June, 2015 it is not advised to enter the market with this amount. Investing the minimum amount doesn’t attract the brokers yet and the reliable help was not received with the amount of 30,000 yuan.

The interview did not provide any information on the ways of trading through the mobile applications or online platforms that foreigners can use individually.
7.2 Unknown Sources and ways of A-share trading

Due to the limited number of English-speaking brokers or reliable sources, the information on investment was also gathered through social media and personal connections of the author. The major amount of information came from individual foreign investors trading on the amateur basis. With the same limitations required, it was advised not to trade B-shares, because of the size of the market and number of listed companies. Instead, it was advised to have a reliable Chinese citizen to open a Chinese A-shares trading account and invest on their behalf through the mobile applications that are widely available for trading. The sources claimed that the amount of 30,000 yuan is enough to confidently trade A-shares. Moreover, it was mentioned that the comfortable funds may not exceed the amount of 10,000 yuan if traded short-term. The basic knowledge of Chinese is required since there are no mobile apps in English. The sources also claim that the market is getting safer to invest in. However, the best way now is short-term trading since the market is still very volatile.

The official and legal ways of trading Chinese stocks show a lot of difficulties and requirements. However, the foreign traders may be ready to consider not-official ways of investment through the cooperation with Chinese citizens. Chinese culture and language as well as acceptance to see the alternative ways of trading in China can be very useful factors for success.

7.3 Suggestions for Further Research

The topic of investment requires a deep research and frequent updates. The A-shares trading along with Chinese fund trading needs further and deeper research since these are the potential ways to invest in Chinese stocks with a small budget both as a direct investing option and through QFII listed companies. The research on the future prospects of Chinese economy and political plans are other topics that are worth considering when trading Chinese stocks, since those carry the direct influence on the stock market. Trading Chinese stocks listed in other countries should be researched by country’s market policy.
8 SOURCES


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9 APPENDIXES

<table>
<thead>
<tr>
<th>Stock name</th>
<th>ISIN</th>
<th>Last trade</th>
<th>P/E</th>
<th>EPS</th>
<th>Dividend/share</th>
<th>Ex.Date</th>
<th>Payout Ratio</th>
<th>Dividend yield</th>
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<td>Harbin Pharmaceutical</td>
<td>CN0009110379</td>
<td>19.65</td>
<td>32.8</td>
<td>0.3</td>
<td>1.00</td>
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<td>Dong Railway</td>
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<td>0.88</td>
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<td>50</td>
<td>7.62</td>
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<td>China Construction Bank</td>
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<td>4.71</td>
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<td>0.30</td>
<td>Jul 01 2015</td>
<td>33</td>
<td>0.39</td>
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<td>0.19</td>
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<td>Wahen Iron And Steel</td>
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<td>0.05</td>
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<td>Yuan Sheng&amp; Zhen Zinc</td>
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Appendix 1 Dividend giving companies

[http://www.topyields.nl/sse-dividend-index/]